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**MEMORANDUM AND RECOMMENDATION**  
**OF THE**  
**PRESIDENT OF THE**  
**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT**  
**TO THE**  
**EXECUTIVE DIRECTORS**  
**ON A**  
**PROPOSED LOAN**  
**IN AN AMOUNT EQUIVALENT TO US\$150 MILLION**  
**TO THE**  
**REPUBLIC OF KOREA**  
**FOR A**  
**HOUSING FINANCE SECTOR PROJECT**

May 26, 1987

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CURRENCY EQUIVALENTS  
(As of January 1, 1987)

Currency unit - Won (W)  
Won 1.0 - US\$0.00116  
US\$1.00 - W 860

GOVERNMENT OF KOREA  
FISCAL YEAR

January 1 to December 31

WEIGHTS AND MEASURES

1 meter (m) - 3.28 feet  
1 kilometer (km) - 0.62 miles  
1 square meter (sq m) - 10.8 square feet  
1 pyong (py) - 3.3 square meters  
1 hectare (ha) - 10,000 sq m or 2.471 acres  
or 3,024 pyong

ABBREVIATIONS AND ACRONYMS

HFS - Housing Finance System  
ICB - International Competitive Bidding  
KHB - Korea Housing Bank  
LCB - Local Competitive Bidding  
MOC - Ministry of Construction  
NHF - National Housing Fund  
p.a. - per annum  
PAS - Program of Actions and Studies  
PS - Policy Statement

KOREAHOUSING FINANCE SECTOR PROJECTLoan and Project Summary

Borrower: Republic of Korea

Amount: US\$150 million equivalent.

Terms: Repayable in 15 years including 3 years of grace, at the standard variable interest rate.

Onlending Terms: 10% for home purchasers and 5% for the construction of rental accommodation destined for low-income households, both for 20 years.

<u>Financing Plan:</u>	Local	Foreign	Total
	----- (US\$ million) -----		
Government	1,067.4	225.1	1,292.5
World Bank	-	150.0	150.0
<u>Total</u>	<u>1,067.4</u>	<u>375.1</u>	<u>1,442.5</u>

Economic Rate of Return: not applicable

Staff Appraisal  
Report:

No. 6699-K0

MEMORANDUM AND RECOMMENDATION OF THE PRESIDENT  
OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
TO THE EXECUTIVE DIRECTORS ON A PROPOSED LOAN TO THE  
REPUBLIC OF KOREA FOR A  
HOUSING FINANCE SECTOR PROJECT

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1. The following report on a proposed loan to the Republic of Korea for US\$150 million equivalent is submitted for approval. The proposed loan would be for a term of 15 years including 3 years of grace at the standard Bank variable interest rate and would help finance a housing finance sector project. The proceeds would be relent to developers as construction finance, and those loans would be subsequently assumed by home buyers as 20-year mortgages (at 10% p.a. interest) and to developers of housing for rental at 5% p.a. for 20 years. The Government would bear the foreign exchange risk.

2. Background: The housing finance system (HFS) in Korea is dominated by one major institution, the Korea Housing Bank (KHB), which has its own mortgage lending program and also administers the social housing finance window, the National Housing Fund (NHF), on behalf of the Ministry of Construction. KHB (including NHF) provides almost 90% of housing loans made, although this financing covers only about one fifth of the value of new construction. A World Bank sector study, which was discussed with the Government about one year ago, identified the small size and underdeveloped state of the HFS as a key constraint in the housing sector and recommended changes. The sector report also reviewed the Government's program of social housing and made a number of recommendations to improve its efficiency, particularly with respect to targeting the program more effectively on low-income households.

3. Project Objectives. Consistent with the recommendations of the sector report, the objectives of the proposed project would be to support measures designed to expand the HFS and increase its effectiveness in improving housing conditions, especially for the low-income population. This objective would be accomplished gradually, by differentiating between the social and economic goals for the housing sector and the HFS. Measures introduced under the project would focus NHF activities on lower-income households by restricting access to loans on the basis of income and by reducing the maximum size of eligible unit. The project also supports actions to strengthen KHB's competitive position in savings markets and to tap new institutional sources of funds. In addition, further means would be studied for expanding the market-based housing finance system to better serve the needs of middle-income households in line with the liberalization of the financial sector.

4. Project Description. A two-year (mid-1987 through mid-1989) time-slice of NHF's lending program would be supported under the proposed project. NHF plans to lend about US\$1.4 billion equivalent during the project period, primarily for small housing units. Disbursement would be against NHF's actual lending.

5. The basis of the sector loan is the commitment of the Government to a Policy Statement (PS) and a Program of Actions and Studies (PAS), which incorporates actions already under implementation as well as actions contemplated for the future development of the HFS. In particular, the Government has agreed to expand the HFS on the basis of market principles, to target social housing programs to lower-income groups, and to stimulate an increase in the construction of low-income housing for rental. Staff of key sector institutions would receive training to broaden and enhance skills. The project also includes studies to define further actions. Total cost of the project is estimated at about US\$1.4 billion equivalent with a foreign exchange component of US\$375 million equivalent (26%). A breakdown of costs and the financing plan are shown in Schedule A. Procurement and disbursement are presented in Schedule B. A timetable of key project processing events and the status of Bank Group operations in Korea are given in Schedules C and D, respectively. The Staff Appraisal Report, No. 6699-KO, is being distributed separately.

6. Rationale for Bank Involvement. The project would facilitate continuation of the already fruitful dialogue between the Government and the Bank on housing finance policies. In addition to policy directions, the dialogue has helped in defining and establishing the order of the specific actions required to implement the policy changes, and in transferring to Korea the housing finance experience of other countries. The proposed sector loan fits well with a country lending strategy which places greater emphasis on sector and policy-based lending consistent with the needs of a maturing economy. The Bank's sector report was discussed with the Government in January 1986 and its recommendations form the basis for the Policy Statement and Program of Actions and Studies which was adopted by the Government on April 12, 1987.

7. Agreed Actions. The Government has adopted:

- A. a Policy Statement which outlines the basic policies to be followed in developing both the market-based HFS and the NHF;
- B. a Program of Actions and Studies for the NHF that includes:
  - a significant reduction in the maximum size of unit financed,
  - the introduction of income criteria for smaller units to restrict access to low-income households,
  - increased involvement of the private sector,
  - increased financing for low-income rental housing, and
  - identification of other mechanisms to improve the rental market for lower-income households through a study which reviews recent NHF rental programs as well as the impact of current regulations and incentives on the rental market;

C. a Program of Actions and Studies for the market-based system that includes:

- expansion of the HFS through amendment of the KHB Act to include increased capitalization and expanded powers for KHB,
- gradual increases in the size of mortgages from KHB,
- increased use of nondeposit funds, and
- identification of improvements in resource mobilization and lending instruments through a study which reviews the long-term outlook for all present sources of funds, develops concrete proposals for issuing longer-term bonds in capital markets, assesses the demand for specific new types of loans, and develops an implementation program consistent with ongoing financial sector reform.

8. Justification. The principal justification of the project is that it would assist the Government in reforming the HFS to make it a more effective tool for achieving housing policy objectives and a more efficient channel for resources flowing to the housing sector. This would be achieved by supporting measures to target public expenditures more effectively towards low-income households and, eventually reduce the relative size of public sector programs. The assistance rendered to those who qualify for NHF loans could thus be more valuable than if a larger number were eligible. The project also supports Government's complementary efforts to expand the market-based supply of mortgages by assisting in establishing a program for KHB that will permit it to better respond to the demand for housing loans from all Koreans. Borrowers would benefit both from increased availability of loans as well as from the efficiency gains of mobilization through the formal finance system.

9. Risks. The main risks of the project involve noncompliance or delayed compliance with agreed housing strategies. However, these risks are small because the sector dialogue has resulted in close coincidence of views on desirable policy directions and institutional reforms. The Government has already taken action on many important agreed measures.

10. Recommendation. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank and recommend that the Executive Directors approve the proposed loan.

Barber B. Conable  
President

Washington, D.C.  
May 26, 1987

Schedule A

KOREA

HOUSING FINANCE SECTOR PROJECT

Estimated Costs and Financing Plan  
(US\$ million)

	Local	Foreign	Total
<u>Estimated Cost</u> <sup>a/</sup>			
NHF Housing Program			
Rental Units	443.0	155.7	598.7
Units for Sale	624.1	219.2	843.3
Training, Studies	0.3	0.2	0.5
<u>Total Project Cost</u>	<u>1,067.4</u>	<u>375.1</u>	<u>1,442.5</u>
<u>Financing Plan</u>			
Government	1,067.4	225.1	1,292.5
World Bank	-	150.0	150.0
<u>Total</u>	<u>1,067.4</u>	<u>375.1</u>	<u>1,442.5</u>

a/ Inclusive of taxes estimated at US\$40.4 million.

Schedule B

KOREA

HOUSING FINANCE SECTOR PROJECT

Procurement and Disbursement

Procurement. The proposed project involves a time-slice of a program using procurement procedures acceptable to the Bank. The criteria to be used for the selection of subprojects have been reviewed and are acceptable to the Bank. In two previous housing projects undertaken by the Korea National Housing Corporation (KNHC) with Bank financing, local competitive bidding (LCB) procedures were modified to include international competitive bidding (ICB) for contracts of more than US\$2 million. However, this modification has proved to be redundant because foreign firms have shown no interest in bidding for housing contracts in Korea. Nor have any foreign firms applied for prequalification in response to internationally placed advertisements. Therefore, ICB is not proposed for the present project. Instead, all KNHC and local government contracts eligible for Bank financing would be let by prevailing LCB procedures that are consistent with Bank guidelines. In the case of private developers who do their own construction work, the Ministry of Construction applies selection procedures that reasonably ensure competition and efficiency. All contracts costing US\$8 million or more would be reviewed in advance by the Bank. Studies would be contracted to experienced local research institutes under terms of reference acceptable to the Bank.

Disbursements. Disbursements would be against NHF subloans at the rate of 40% of expenditures.

Estimated IBRD Disbursements

	<u>Bank Fiscal Year</u>			
	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
Annual	25	44	56	25
Cumulative	25	69	125	150



Schedule C

KOREA

HOUSING FINANCE SECTOR PROJECT

Timetable for Key Project Processing Events

(a) Time taken to prepare	One year
(b) Prepared by	MOC with Bank assistance
(c) First Bank mission	January 1986
(d) Appraisal mission departure	February 1987
(e) Negotiations	May 1, 1987
(f) Planned date of effectiveness	August 1987
(g) Relevant PCR's and PPARs	none

THE STATUS OF BANK GROUP OPERATIONS IN THE REPUBLIC OF KOREA /a

A. Statement of Bank Loans and IDA Credits  
(as of March 31, 1987)

Loan or Credit Number	Calendar Year	Borrower	Purpose	Amount (\$ million) (less cancellations)			
				Bank	TW	IDA	Undisbursed
Sixty-two loans and eight credits fully disbursed				3,815.93	40.00	115.58	
1774	1979	Republic of Korea	Population I	30.00			8.16
2072	1982	Republic of Korea	Water Supply	83.01			0.79
2112	1982	KTDC	Technology Development	49.08			1.27
2215	1982	Republic of Korea	Machinery Industry	56.99			15.74
2216	1982	Republic of Korea	Nat. Urban Land and Housing	100.00			0.09
2228	1982	Republic of Korea	Provincial and County Roads	125.00			29.00
2267	1983	Republic of Korea	Coal and Cement Distribution	54.45			15.30
2309	1983	Republic of Korea	Industrial Finance	255.00			20.92
2350	1983	Republic of Korea	Second Water Supply	65.00			14.78
2388	1984	Republic of Korea	Jeonju Regional Development	47.31			26.18
2392	1984	Republic of Korea	Highway Sector	220.00			70.44
2427	1984	Republic of Korea	Education Sector	100.00			68.98
2473	1984	KTDC	Second Technology Development	50.00			21.35
2491	1985	Republic of Korea	Water Supply	95.00			46.46
2514	1985	SMC	Urban Transportation	28.76			22.24
2515	1985	SMIPC	Small/Medium Industry	21.00			17.89
2549	1985	Republic of Korea	Fourth Agricultural Credit	25.00			4.31
2571	1985	Republic of Korea	Second Industrial Finance	222.00			174.83
2600	1985	Republic of Korea	Seoul-Busan Corridor	35.59			22.89
2615	1985	Republic of Korea	Fourth Water Supply	35.74			32.86
2671	1986	KEPCO	Second Power	230.00			194.83
2704	1986	KLDC	Urban Land Development	150.00			130.81
2726	1986	Republic of Korea	Pusan Port	141.00			131.00
Total				6,035.86	40.00	115.58	1,071.12
Of which has been repaid				1,498.19	6.94	10.32	
Total Now Outstanding				4,537.67	33.06	105.26	
Less: Amount sold				64.32			
Total Now Held by Bank and IDA (prior to exchange adjustment)				4,473.35	33.06	105.26	
Total Undisbursed				1,071.12	-	-	1,071.12

/a The status of the projects listed in Part A are described in a separate report on all Bank/IDA-financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.

B. Statement of IFC Investments  
(As of March 31, 1987)

Fiscal Year	Obligor	Types of Business	Amount (\$ million)		
			Loan	Equity	Total
1968	KLB (KDPC)	Development Financing	-	0.7	0.7
1969	Honam Silk Co.	Textiles	1.4	0.3	1.7
1970	Atlas Paper	Pulp and paper	4.5	0.5	5.0/a
1971	Korea Investment Finance Corp.	Capital Market Development	-	0.7	0.7
1974	KLB (KDPC)	Development Financing	-	0.4	0.4
1974	Korea Investment Finance Corp.	Capital Market Development	-	0.3	0.3
1975	Gold Star & Co. Ltd.	Electronic Products	16.0	1.3	17.3
1975	Korea Securities Finance Corp.	Capital Market Development	5.0	0.6	5.6
1975	Tong Yang Nylon Company, Ltd.	Synthetic Fibers	6.9	2.1	9.0
1975	Hae Un Dae Development Company Ltd.	Tourism	2.8	0.7	3.5
1976	Korea Investment Finance Corp.	Capital Market Development	-	0.4	0.4
1976/84/87	Chonju Paper Mfg. Co.	Paper	5.0	1.0	6.0
1976/86	Korea Zinc Co. Ltd.	Zinc	21.0	4.0	25.0
1976	KLB (KDPC)	Development Financing	17.8	-	17.8
1976	Gold Star & Co. Ltd.	Electronic Products	10.0	0.4	10.4
1977	Gold Star & Co. Ltd.	Electronic Products	-	0.2	0.2
1977	KLB (KDPC)	Development Financing	-	0.3	0.3
1977	Korea Securities Finance Corp.	Capital Market	-	0.5	0.5
1977	Korea Development Leasing Corp.	Capital Market	15.0	0.4	15.4
1978	KLB (KDPC)	Development Financing	-	1.1	1.1
1979	Gold Star & Co. Ltd.	Electronic Products	-	1.7	1.7
1979	KIFC	Capital Market	-	0.6	0.6
1979	Korea Development Leasing Corp.		-	0.2	0.2
1979	Gold Star & Co. Ltd.	Electronic Products	-	1.5	1.5
1980/84	Gold Star & Co. Ltd.	Electronic Products	-	8.1	8.1
1980	Korea Investment Finance Corp.	Capital Market	-	0.6	0.6
1980/82/84	Korea Securities Finance Corp.		-	2.3	2.3
1980	KLB (KDPC)	Development Financing	-	2.2	2.2
1981	Taihan Bulk Terminal Co. Ltd.	Grain Port Terminal	7.0	2.5	9.5
1982/85	KIFC	Capital Market	-	1.1	1.1
1982	K-TAC (Korea Technology Advancement Corp.)	Research & Development	-	0.6	0.6
1983/85	KDIC	Money & Capital Market	-	5.9	5.9
1984	Halla Cement	Cement Const. Material	4.3	3.9	8.2
1985/86	Korea Fund	Money & Capital Market	-	12.8	12.8
1987	Korea Business & Research Information	Money and Capital Market	-	0.1	0.1
<b>Total Gross Commitments</b>			<b>116.7</b>	<b>60.0</b>	<b>176.7</b>
Less cancellations, terminations repayment and sales			107.8	28.0	135.8
<b>Total Commitments Now Held by IFC</b>			<b>8.9</b>	<b>32.0</b>	<b>40.9</b>
<b>Total Undisbursed</b>			<b>2.0</b>	<b>4.3</b>	<b>6.3</b>

/a Cancelled at the request of the Company.

